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SIPDIS

SENSITIVE

DEPT FOR AF/E, AF/EPS
DEPT PASS to USTR FOR BILL JACKSON
DEPT PASS TO DEPT OF LABOR ATTN ILAB FOR KELLY BRYANT
TREASURY FOR ANN ALIKONIS
LONDON AND PARIS FOR AFRICA WATCHERS

SIPDIS

E.O. 12958: N/A
TAGS: KPRV EAID ELAB ECON KE UG
SUBJECT: Kenya and Uganda Privatize the Railroad

Ref: Nairobi 1668

Sensitive-but-unclassified. For USG channels only.

¶1. (SBU) Summary: Kenya and Uganda are at last moving to revive the storied 1,500 mile rail line from Mombasa to Kampala by concessioning the railroad on both sides of the border to a private sector consortium led by a South African firm. This form of privatization is a welcome attempt to fix a major piece of the region's infrastructure whose dismal performance has for years been a serious fiscal burden and a major constraint on regional economic development. Despite the recent passage of long overdue privatization legislation in Kenya, it is premature to view the railroad deal as the start of a new wave of badly needed privatization in Kenya. End summary.

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The Railroad: From Rolling Stock to Laughing Stock
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¶2. (U) The 1,460 mile railroad linking the East African port of Mombasa with Kampala, nicknamed the "lunatic express," is the stuff of lore. It was begun in 1898 and completed in stages, finally reaching Kampala in 1937. Long before that, it was used by the British colonial authorities to open up, exploit, serve, and subjugate the interior of their East African empire. Kenya's present-day capital, Nairobi, did not exist before the railway, and was built to service it. In the more recent decades since independence, however, the state-owned Kenyan portion of the railway has been run into the ground by inept management, rampant patronage and corruption, and a dearth of new investment.

¶3. (SBU) As such, far from being a lifeline for the growth and development of Kenya and the wider region, the railway has long since become an albatross and a chokepoint. Twenty years ago, 80 percent of the cargo going to Uganda from Mombasa port was transported by rail. Today, because of the severe deterioration of rail beds and rolling stock, only 20 percent does so (reftel). Cargo that does go by rail is slow and irregular, confounding businesses and raising costs across the economy. The consequent diversion of most cargo transport to roads has further compounded the container logjam at Mombasa port and has greatly contributed to the severe overtaxing of Kenya's equally neglected, potholed road network (septel).

¶4. (U) In terms of the fiscal burden, Kenya's Transport Ministry, which oversees the Kenya Railways Corporation (KRC), reports that subsidies to keep KRC afloat amounted to over $40 million over the past three years, and the company is reported to be in debt to the tune of nearly $270 million -- both huge numbers in the Kenyan context.

The Solution: A 25 Year Concession

¶5. (SBU) In essence, the plight of the railroad became so dire that a consensus emerged that bringing in a private operator was the only way to improve service and get the capital investment needed to rehabilitate the rolling stock and bring in needed locomotives. Recognizing this, while also seeing the potential a revived regional rail network held for the region's economic development, the governments of Kenya and Uganda began working seven years ago to negotiate a scheme to privatize the railroad on both sides of the border. Rather than pursue pure privatization, the two governments opted instead to "concession" the rail line for a 25-year period to a private operator, in essence handing over management and operations (and any potential profits) to a private contractor in exchange for agreed-upon capital improvements and a share of annual revenues.

All Aboard! Here Comes Rift Valley Railways!

¶6. (SBU) This process, undertaken with assistance from the World Bank and partially funded by USAID/Kenya, finally culminated on October 14, 2005, when the Governments announced that a consortium led by South African firm Sheltam Trade Close Corporation had won the competition for the concession, beating out seven initial bidders, and one other finalist, a consortium led by Rail India. Under the terms of the deal as disclosed publicly, the consortium offered upfront payments of $3 million to the GOK and $2 million to the Government of Uganda (GOU), to remit 11.1% of gross revenues each year to be shared by the two governments, and to pay $1 million annually to the GOK for the right to run passenger service in Kenya. Thanks to the last minute passage of an amendment to the Kenya Railways Corporation Act prior to a divisive constitutional referendum in late November, the way is legally paved for Sheltham to take control of the money-losing KRC parastatal (and its Ugandan counterpart) on April 1, 2006. After winning the concessioning tender, the Sheltam consortium quickly announced its intention to rename the railroad Rift Valley Railways.

Working on the Railroad - No More

¶7. (U) KRC is expected to terminate 5,600 of its 9,200 employees, many of whom are casual workers whose salaries have been paid irregularly by the cash-strapped parastatal. The deal mandates that 30 KRC employees will be transferred to the concessionaire and spells out the criteria for hiring others upon privatization. According to KRC contacts, the World Bank is providing a Ksh9.6 billion (about $128 million) loan for the project, mainly to fund severance and retirement benefits, retrain retrenched workers, and set up a retirement benefit scheme. Under the deal, the Kenyan government will shoulder KRC's outstanding debts, and it has said it will service that debt using the proceeds paid to it by the concessionaire.

Comment

¶8. (SBU) It's far too early to call the railroad concessioning a success, but the two governments and the

World Bank deserve credit for pushing this through, and the bottom line is nearly anything will be an improvement over the current dismal performance of KRC. While we don't know much about Sheltam, we also hope that its African roots and experience will give it an advantage in resuscitating the once-great East African railway system.

¶9. (SBU) It's also too early to say if this deal marks the start of a new wave of privatization in Kenya. The railway deal was cleverly anchored in existing railway legislation and thus did not depend on the much-delayed new privatization law, which only passed in parliament in October. We suspect that the latter law will take a great deal of time to implement, and will not bear tangible fruit in the form of privatized parastatals for a year at least, and likely longer given ongoing policy paralysis and leadership instability in Kenya.
Bellamy